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ABSTRACT

Some of the faults and values implied by present methods of financing higher education are examined, and new financial arrangements are proposed. Problems with the current system include: the price to the consumer of higher education in relation to its cost of production, tuition gaps among schools, and evaluating the price in relation to value of education. It is important to consider who benefits from higher education and how much of the benefits are paid for by the beneficiary. The present system does not yet provide equal educational opportunities and provides even less choice, and therefore, does not express some of our most important democratic values. The proposed financial system would provide that the federal government establish a trust fund that would advance money to students in order to pay for higher education, and that students should repay these advances out of income through payroll withholding. Repayment could be carried out over a very long time; there would be no interest on the advance; and only those who had no income would be exempt from repayment. The amount advanced would be restricted to tuition actually paid; advances would be available only to undergraduates enrolled in degree programs in accredited institutions, and freshmen would not be eligible. Other aspects and implications of this proposal, called the "tuition advance fund," are discussed. (SW)

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The Tuition Advance Fund: A Proposal for Funding Higher Education

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I should like to begin by saying that the apparent balance of our panel tonight is specious. Although I come from the independent sector and President Terrell from the state sector, I am not speaking as a representative of the independent sector, or even as a citizen of it. I believe that the interests of the two sectors in our system of higher education are essentially the same. This is especially the case with regard to the topic I am discussing tonight--the financing of higher education. Although most of you know that I yield to no one in my support of the independent sector, I have spent the majority of my teaching and administrative life in the state sector, and my diverse experience has persuaded me that we have a single system of higher education with largely congruent interests.

I should have preferred to delay by another six months the presentation of the proposal I am making tonight, because I had planned to consult more widely in both sectors and to develop the proposal still further. But this Assembly* seemed an especially propitious occasion for introducing such a proposal, and I am therefore bringing it forth before it has been entirely licked into shape.

Values have long been a cottage industry in higher education, and are now rapidly attaining the status of mass production. Most of our values have been the object of relentless examination, and few of the beliefs common among academics at the end of World War II have been spared the most searching scrutiny. One set of values, however, have been relatively safe from scrutiny: those implicit in the way we finance ourselves. Aside from the routine piety that if we accept federal aid we must expect federal regulation, the bottom line in our fiscal deliberations has almost always been purely financial.

Tonight I want to examine some of the values implied by our present method of financing higher education, suggest that they are dissonant with the rest of what we believe, and propose some new arrangements for financing higher education that can reduce the dissonance.

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*This essay was originally presented as a speech at the 1977 Assembly of the National Center for Education Management Systems. The long-term repayment of educational advances, an idea tracing its roots to the invention of "installment buying," is not original with me. The earliest such proposal known to me was made by Milton Friedman as early as 1945. Another was made by Foster Furcolo when he was governor of Massachusetts; others have been made by the late Allan M. Cartter, Professors Charles Killingsworth of Michigan State and William Vickrey of Columbia, and a panel headed by Jerrold Zacharias of M.I.T. A considerably more ambitious proposal, to cover half the cost of all education from kindergarten through graduate study, was made by Governor Shapp of Pennsylvania during the 1976 presidential campaign. Inside higher education itself, the idea has languished since the late 60's. This is not, I am convinced, because of any intrinsic lack of merit. The times were less favorable to such an idea a decade ago, and I believe that the proposal as submitted here has crucial advantages in clarity and simplicity over earlier ones.

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To begin with, we should recognize that higher education, considered as an economic good, is a very unusual phenomenon. Several economists have noted this. Norman Matlin several years ago published a book with the stimulating if somewhat brittle thesis that what we sell in higher education is not education but prestige, and that a good deal of our financial difficulty grows out of our inability to face this fact and act accordingly. About the same time, James Buchanan and Nicholas Devletoglou collaborated in an equally stimulating work, arguing that although higher education is itself the economic good we sell, the fact that we always sell it well below the market price ensures that it will always be valued less highly than we wish it to be. Neither of these works, which might reasonably have provoked further discussion, attracted much attention among academics.

Some of our economic anomalies are well-known. For one, higher education is invariably supplied to the consumer at a price well below the cost of production. In a state-supported college or university, this price is typically one-fifth of the cost of education, although it may be as low as one-tenth. Even with the higher tuition charged in the independent sector, few institutions support themselves entirely out of tuition. The price charged to the consumer in the independent sector ranges from more than 90% of cost down to less than 50%. Another way of saying this is that every college student, no matter how rich, is on a kind of scholarship, the value of which may exceed $4,000 a year.

Another well-known anomaly is implicit in these figures: the tuition gap. Although as a whole the two sectors contain institutions of comparable quality, the tuition prices differ enormously. That is, goods of the same quality are sold at vastly disparate prices, sometimes varying by a factor of ten. In any other industry, this would be called cutthroat competition. We do not call it that in higher education because such price cutting does not have the effect it has in other areas. The tuition gap is an ever present and agonizing reality for most of the independent sector, but so far most of that sector's institutions are surviving it.

But there are some less frequently observed anomalies. When we come to evaluate the price and value of higher education, we approach the condition delineated in Oscar Wilde's famous definition of a cynic: we know the price of almost everything and the value of almost nothing. Attempting to rate education as value added to human potential, the Bureau of the Census has developed figures that suggest that over a working life, the average college graduate makes $232,000 more than the average high school graduate. But this tells us nothing at all about the value added by a particular college education. As a figure it is no better than saying that over 50 years the worth of the average house appreciates by 800%. It does not tell us anything about the value of individual houses, some of which are overpriced to begin with, some of which are underpriced, and some of which burn to the ground the year they are built.

Similarly, lifetime earnings figures tell us nothing about the financial value of a college education, for this value is very heavily dependent on the native abilities of the consumer who purchases it, the background he comes from and to which he returns, as well as on the use he puts it to. For these reasons, it is impossible to make the price charged to a student equal to the value of his education. Even if by some miracle of omniscience we could do this, the resulting tuition scale would make

higher education free to the least competent and least enterprising, and prohibitively expensive to the most skillful and most hardworking.

Finally, higher education is an extremely expensive commodity--more costly than all but a few exotic automobiles, and as costly as some houses. But unlike automobiles and houses it has little if any value as collateral. Yet for the even moderately successful person, the actual financial value of a college education increases cumulatively with each year. Although this increase is analogous to the annual appreciation of a well-maintained house, no bank would lend money for a higher education on a thirty-year mortgage.

To deal with these and other fiscal anomalies, we have constructed a system for financing higher education so ramshackle that we should be amazed that it works at all. At one side of the system, the states finance education largely through tax revenues, supplying an extremely expensive good to all comers at a fraction of the cost of production. (Even so, this price is often too high for the most impoverished members of society, many of whom who stand to derive the greatest relative financial benefit from higher education.)

On the other side, the independent sector tries, through needs criteria for financial aid, to limit subsidies to those who need them. But few schools actually charge even their most affluent students the full cost of their education: all students get some subsidy, and generally the richer the school the greater this automatic and indiscriminate "scholarship." Even with such subsidies, the schools of the independent sector charge a tuition price that either puts many parents heavily in debt, or, as parents become unable to assume such debt, puts many students heavily in debt at the start of their working careers.

To help pay the cost of education for students in both sectors the federal government has established programs of student aid that mesh with varying degrees of success into widely different programs and conditions that obtain in the various states. The more we perceive the ramshackle nature of this system, the more we patch and complicate it: its very management now requires substantial institutional commitment of time and money, and a burgeoning federal bureaucracy, to administer it.

In constructing our total system for financing higher education, we have not considered seriously who benefits from higher education and how much of the benefits should be paid for by the beneficiary.

It is easy to say that the benefit of higher education is partially bestowed upon individuals and partially upon society. But because it is hard to measure the societal benefit it is very much harder to apportion the benefit between the two. Because the average college graduate makes, over a working lifetime, $232,000 more than the average high school graduate, the average personal financial benefit from higher education far exceeds its total financial cost. If an individual were to pay for all his higher education, he would receive direct financial benefits far in excess of what he actually paid, he would receive its extensive nonfinancial benefits gratis, and society would receive its vast benefits as a dividend.

In theory, there is no reason why, on the average, the total cost of higher education should not be borne by those who receive it. Now, from my Kantian studies, I accept the proposition that whatever is sound in theory must also work in practice. The reason why no one would now think

it practicable to require students to pay for their own higher education is that because we customarily require that higher education be paid for as it is acquired, rather than as it is used, few students can afford to pay while they are students. If we allowed students to pay later as they used their education, we would allow them to pay later over a lifetime. Indeed, our present system of student loans for higher education is a very inadequate attempt to allow payment over the period of use. Because it is inadequate, we fall back on other expedients for paying the costs that students cannot earn or borrow. Typically, we get some of it from parents, some from taxpayers, and some from philanthropists. These people are on the whole better able to pay for higher education than students are, but the largest, most helpful group--the parents--are not much better able to.

Further, some of these people--some of the parents and some of the taxpayers--never derive any direct personal benefit from higher education, because they never went to college. And others may have benefited neither directly nor indirectly from higher education. The poor pay taxes to fund higher education but may not share even in its societal benefits to a significant extent. Because the state provides its subsidy to all comers, all states tax the poor to assist in the education of the children of the rich. Taking from the poor to give to the rich is not behavior that most of us would consciously approve of, and yet our customary and generally unchallenged practice in funding the state sector does just that. Nor is the independent sector innocent of such inverted Robin Hoodism: it is not uncommon for comparatively non-affluent parents to pay for the education of children who will some day be far richer than themselves.

Finally, in addition to these faults, the present system does not yet provide equal educational opportunity and provides even less for choice. It does not, therefore, express some of our most important democratic values. And if we have as a common value the belief that whenever possible people ought to pay for what they get, we can see that our present system of financing higher education fails to express this value.

But we could design a system that could express these values, and tonight I want to outline a system for financing higher education that would do so. It is a system that transfers the primary responsibility for financing higher education to those who benefit most directly from it, and does so in a fiscally sound manner that is fully consonant with our commitment to equality of educational opportunity.

The essential feature of this system provides that the federal government establish a trust fund that would advance money to students in order to pay for higher education, and that students should repay these advances out of income through payroll withholding.

Before discussing such a plan in detail, I want to point out that it would differ fundamentally from our present loan programs. First, repayment would be contingent upon income. In an extreme case, a student who borrowed several thousand dollars from the trust fund and over the rest of his life never had any income would have derived no personal financial benefit from his education. He would, under the arrangement I propose, pay nothing for it. Its cost would, therefore, be borne by society as part of its commitment to equal educational opportunity. Conversely, a student who in later life made a great deal of money would, under a ceiling, pay for somewhat more than the cost of his education. This would not be a novelty in principle or in practice: through the progressive federal

income tax, a financially successful student now contributes to present federal student aid programs out of proportion to his share.

Second, repayment could be carried out over a very long period of time--the approximately 45 years comprised by a contemporary working lifetime.

Third, although the amount to be repaid would include a one-time service charge for administrative and other costs, there would be no interest charged on the advance. The federal taxpayer would initially subsidize the trust fund as part of the nation's commitment to higher education. But the trust fund would become self-sustaining within a generation.

Finally, there would be no question of default. Anyone who received an advance from the trust fund would make annual payments through withholding until the advance was paid back. Only those who had no income would be exempt from some repayment. In addition, after this plan has been subjected to careful actuarial study, we may find that it is fiscally and socially desirable to forgive from 25% to 50% of the obligations of non-employed spouses.

Let me now present a somewhat more specific proposal. In drawing up this proposal, I have included a number of limitations aimed at developing a workable pilot program suitable for initial presentation to the Congress. The first of these restricts the amount to be advanced to tuition actually paid. There is no reason in principle why a student should not get an advance for all his expenses, but in the first years of the trust fund it is important to limit the amount of the annual payout.

Next, the advances would be available only to undergraduates enrolled in degree programs in accredited institutions. Although this also has the effect of limiting the annual payout, its more important function is to recognize that the financial benefits of higher education derive not from miscellaneous study but from the completion of a coherent course of study and the possession of a degree. And although there is no reason in principle to exclude professional education, affluent professionals at least earn enough money to avail themselves of conventional loan programs, especially if they have funded their undergraduate education through a tuition advance.

Third, advances would not be available to freshmen. Ideally, the advances would go only to students who have demonstrated the capacity to graduate and are likely to do so. Limiting eligibility to those who make it into the second year is one way of helping to ensure that this will be the case. Since this system of educational advances would substantially reduce the need for such current programs as the BEOG and the SEOG, these programs could be remodelled to meet in full the need for freshman-year aid, to the end of assuring all students a chance to prove themselves reasonable risks for the Tuition Advance Fund.

Typically, tuition in the independent sector is $2500 a year; a student in this sector could currently receive a maximum advance of $7500. In the state sector, tuition is now typically $620 a year. A student in that sector could receive a maximum advance of $1860.

Repayment would be made by a yearly payment of 1½% of gross income, paid either through payroll withholding or (for the self-employed) estimated tax payments. That is, someone who had a before-tax income of

$20,000 would repay $300 in that year. Someone who had a before-tax income of $100,000 would repay $1500 in that year. Someone with a before-tax income of $7500 would repay $112.50 in that year.

These figures, of course, are determined on the basis of current tuition rates. Future borrowing, as well as future repayments, would need to be adjusted for inflation. Just how long it would take any one student to repay an advance would depend on variations in annual income. But a student who enjoyed a high income would repay quickly, and might after repaying the original advance continue to pay a surcharge--perhaps not to exceed 50% of the advance itself. I need not point out that a 50% surcharge on an interest-free loan repayable over decades is by no means usurious. And one whose income was, over a lifetime, seriously below the average would retire with a substantial portion of the advance unpaid and in effect forgiven.

The trust fund to handle these advances would not be an extremely costly project for the federal government. Although the available figures on enrollment by class in the two sectors are scandalously inadequate, available figures indicate that currently approximately 925,000 students in the independent sector and approximately 3.7 million in the state sector would be eligible to participate in a Tuition Advance Fund of this sort. The total annual advance that these students would be eligible for would be $4.6 billion--$2.3 billion to students in the each sector.

The magnitude of the total cost of a Tuition Advance Fund is best appreciated by considering that we now spend nearly as much a year on candy, about three times as much on tobacco and about seven times as much on alcohol.

The cost of a Tuition Advance Fund is even more reasonable when we consider that it is, unlike most federal program costs, self-liquidating. Although Congress will initially have to appropriate funds to pay advances, as repayments are received and invested, an increasing proportion of the benefits will be funded from payback and interest. Eventually, payback and interest will take over the entire cost of paying the advances.

It should be realized that the actuarial deck is stacked in favor of the Tuition Advance Fund. Next year will see the largest high school graduating class in this century. Each year thereafter, the size of college and university freshman classes will decline until by 1990 they have become at least 30% smaller. This means that the annual benefit to be paid out of the Fund, in constant dollars, will decline annually. Against this decreasing need for payout there will be an annual increase in payback as each year another class of beneficiaries joins the work force and begins repayment. Each year, the ratio of producers to consumers will rise; in this respect, the Tuition Advance Fund is totally unlike the Social Security fund, which is in trouble partially because of a decrease in the ratio of producers to consumers.

These costs will be seen to be even more reasonable when we consider how the program they fund can simplify the administration of federal student financial aid. For all students will become in effect independent of their parents, and no need assessment will be required for any of them. "Need," under such a program, is demonstrated by presenting one's tuition bill.

In the six years since I first began discussing this principle of funding, I have received many useful criticisms that have led me to specify certain safeguards. For one, in order to ensure that no institution takes advantage of the proposal to enact windfall tuition increases, I believe that institutions that accept students funded under these provisions should accept some cap on their tuition. It would be reasonable to allow institutions whose tuition is below the national maximum a one-time increase of 10%, and to index all tuition increases thereafter to the Consumer Price Index. For another, to avoid either the erection or conversion of existing institutions into diploma mills, eligibility should be made very difficult for new institutions or institutions that show excessive growth. We are entering a period when the student pool will be decreasing, and we should rightly discourage substantial increases in capacity.

I have also received some criticisms that seem to me on reflection to be ill-founded. One of these is that this proposal would set up a terrifying new bureaucracy. I see no need for or danger of this, for suitable competent bureaucracies already exist. Both the Internal Revenue Service and the Social Security Administration have broad experience in dealing with millions of individual accounts. Either of these government departments could administer the collection of TAF repayments by modification of existing systems. Or a comparatively small new department could share the use of computer systems already maintained by the SSA or the IRS. All that would be required would be the establishement of special TAF accounts which repayments would be credited. The payment of benefits in each TAF account would normally be concentrated for each account within a three-year period. The administering agency could easily manage the trust fund and its cash flow, a purpose for which present systems ought to be easily adaptable.

It has also been suggested that such a system would impose great burdens on employers. I do not believe that this is so either. A new box would have to be added to the form on which employees claim exemption. This box would ask "Do you have an unsatisfied obligation to the Tuition Advance Fund?" For any employee who answered yes, the employer would forward an additional 1½% of gross income to the funds processed to the administering agency. In turn, whenever it found an individual TAF account finally repaid, the agency would send the account-holder a certificate of discharge, which he would take to his employer to secure suspension of the 1½% withholding. These procedures have close analogues in the present administration of the F.I.C A. tax, and present no novelties.

Another objection that has sometimes been raised is that there is no reason why higher education should receive a privileged position by being allowed to collect debts owed it through the withholding tax. This objection mistakes the reality. The "debt" is not owed to higher education but rather to the federal treasury. Further, the adoption of such a scheme would simply admit what is already the fact, that higher education is a national priority of the same order as health and welfare and deserving of similar government assistance for the administration of partial self-funding.

Finally, it has been suggested that this is a plan hostile and even dangerous to the state sector. I hope I am realist enough not to propose a program that is either of these. I know I am idealist enough. It should be realized that this proposal does nothing to narrow the present tuition gap, but simply defers its payment. Under a tuition advance

scheme, I believe that those students who now prefer the state sector will continue to do so. In any event, the cap on enrollments I have suggested would prevent the independent sector from accepting any mass migration from the state sector even if it materialized. Moreover, there are substantial affirmative advantages in this plan for the state sector. Its students will be benefited as effectively as those in the independent sector by being able to defer tuition payments. There are many state institutions at which tuition, although much lower than in the independent sector, represents a substantial burden for those who must pay it. For some students, even a highly subsidized tuition is too high. The institution of a Tuition Advance Fund would remove an important obstacle to educational opportunity for such students. Even more important, the provisions of this plan would make it simple to index state-sector tuition to the cost of living without imposing any immediate new cost on state-sector students. Tuition increases to meet new economic realities, now a potentially explosive political problem for the institutions of the state sector, could become routine. Without a measure of this sort the state taxpayer is going to reach a limit that will prevent the academic enrichment of state institutions. They will have to turn to alternative sources of funding; the Tuition Advance Fund is an alternative source that is fully in keeping with our commitment to equal educational opportunity. It would be reasonable to allow for a substantial measure of equalization in tuition among the various state systems before applying the 10% cap I have suggested for tuition. With such a mechanism, the institutions of the state sector would be able to share the burdens of inflation with their students. Tuition advances would be fully portable, and would further save the states from the problems that will otherwise be presented if they are required, as now appears likely, to treat all students but out-of-state freshmen as state residents.

In return for a temporary federal program costing a little less than twice what we now spend on pet food, we could establish a means to make the full price of tuition in any institution available to any serious student, no matter what his financial background. We could ensure that the average person paid for the higher education of no one but himself, and that no one for whom higher education proved a fiscal delusion would have to pay for it.

Although it is a proposal that is radically different from the way we do things now, it is far closer to our values than the present way. We should not be put off because the approach seems different. If we are serious about those values, we will give very careful consideration to the idea of a Tuition Advance Fund.